



## SECTION 1

# The Fiscal Context for the 2003-05 Budget

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This section offers our revenue and caseload trends information as of March 2002.

## 1.1 Forecasts and trends

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**The economy in 2003-05 is predicted to grow at a moderate pace, rebounding from the recession in the current biennium. However, rapid growth in health care costs and the dedication of revenues under Initiative 728 will make it difficult to balance the General Fund budget in the 2003-05 Biennium.**

Due to a slowing economy and voter approved measures which lowered taxes and increased mandatory spending, the 2001-03 biennial budget adopted in June 2001 relied on more than \$600 million in reserves to balance resources and expenditures.

As a result of worsening economic conditions, including the effects of the September 11 terrorist attack, a national recession, and large layoffs in the state's aerospace industry, the General Fund (GF-S) 2001-03 Biennium revenue forecast declined by \$1.2 billion since the biennial budget was adopted in June 2001. Increasing caseloads in K-12 public schools, prisons, and medical assistance, together with increasing per capita medical assistance costs and other costs, added \$400 million in additional mandatory spending pressures. As a result, the Legislature was faced with a new \$1.5 billion gap as it deliberated over the 2001-03 supplemental budget.

In February 2002, the Economic and Revenue Forecast Council (ERFC) predicted that the state's economic downturn would continue through calendar year 2002, with a rebound expected in the first quarter of 2003. The ERFC predicts a modest rebound in the 2003-05 Biennium. Washington personal income is expected to grow at an annual rate of about 5.5 percent in the 2003-05 Biennium, about the same as the United States rate.

Excluding the effects of Initiatives 728 and 747 (which together reduce GF-S revenue by nearly \$900 million in the 2003-05 Biennium), underlying revenues are expected to grow about 5.4 percent per year, slightly below the average of the previous five biennia. After taking the initiatives into account, General Fund revenues are expected to grow at a much slower rate of 4.0 percent per year.

The 2001-03 supplemental budget passed by the Legislature and signed by the Governor addresses the \$1.5 billion gap with almost \$700 million in budget cuts, almost \$150 million in revenue enhancements and money transfers to the General Fund, one time use of \$450 million in tobacco securitization funds, and use of reserves. This budget closed the current gap between resources and expenditures and reduced the expected gap for the 2003-05 Biennium from \$3.4 billion to under \$1 billion.

**How may population, caseload, and inflation trends affect the budget?**

The latest forecast of the state population (November 2001) predicts general population growth rates of 1.1 percent for Fiscal Year 2004 and 1.1 percent for Fiscal Year 2005. Changes in the number of persons in selected age groups within the general population will place new demands on, and make new contributions to, our economy and government. Similarly, growth in certain caseloads can have a significant impact on the amount of General Fund-State revenues available for other uses. There are several examples where population or expenditure trends might affect the state budget:

- The K-12 school age population is forecast to grow at a slower rate than the rate of growth in the general population during the 2003-05 Biennium.
- The population of working age adults in their prime earning years and the elderly population will continue to grow over this period as well.
- The 85 and over age group will grow at a higher rate than the general population, about 4 percent per year for the next biennium. This will impact our long term care caseloads.
- The inmate population is forecasted to grow at a higher rate than the general population, about 2.4 percent per year for 2004 and 2005.
- Medical assistance caseloads are expected to grow at rates slightly higher than the general population growth rate. However, the cost per person on the caseload could increase 10 to 15 percent per year due to medical inflation and other factors. (This estimate is subject to change, so please continue to check for updated forecasts.)

You can find more detailed caseload, population, and revenue forecast information at these web sites:

<http://www.wa.gov/cfc/home.htm> and  
<http://www.ofm.wa.gov/demographics.htm>

## 1.2 Initiative 601 and budget considerations

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**What are the specific requirements of I-601?**

Initiative 601 was passed by the voters in November 1993 and placed limits on growth in state General Fund expenditures and on taxation and fees. There are several key provisions of I-601:

***General Fund-State spending limit***

- Establishes annual limits on General Fund-State expenditure growth based on a rolling three-year average of inflation and population growth ("fiscal growth factors"). Fiscal growth factors are based on the past. For example, the fiscal growth factor for Fiscal Year 2004 is based on average inflation and population growth for fiscal years 2000, 2001, and 2002. (It is important to remember that these fiscal growth factors apply to the state General Fund budget in total and not to individual programs or agency budgets.)

***Limitations on fee increases***

- Prohibits agency fee increases from exceeding the fiscal growth factor unless there is legislative approval.

***Fund shifts that change the limit***

- Requires that the spending limit be adjusted for fund shifts. For example, the spending limit is reduced when revenues or program costs are shifted from the General Fund to other funds and increased when non-General Fund revenues or program costs are shifted to the General Fund.

***Re-basing***

- Requires that when actual expenditures fall below the spending limit, future limits be based on the lower amount. This adjustment has been termed "re-basing."

***Emergency Reserve Fund***

- Establishes an Emergency Reserve Fund (a "rainy day account") consisting of revenues collected in excess of the spending limit. Expenditures out of the Emergency Reserve require a two-thirds majority vote in the Legislature.

***Two-thirds majority vote for revenue increases***

- Requires a two-thirds majority of both houses of the Legislature to increase revenues. (The Attorney General has interpreted this phrase to mean new or increased taxes.)

**What are the budget implications of the I-601 formula?**

Under I-601, General Fund-State spending limits are determined by growth in the number of people needing services (as represented by total population growth) and by changes in the cost of providing those services (as represented by general inflation). In fact, some populations or rates of inflation may grow (or decline) at rates different from the general population and inflation rates. Depending on the relative size of those portions of the budget, such differences in growth rates may put pressure on the total funding available under the I-601 spending limit.

**What are the I-601 fiscal growth factors for this budget cycle?**

The preliminary estimate of the fiscal growth factor is 3.3 percent per year in the 2003-05 Biennium. This is slightly lower than the forecasted combined population and general inflation rate of 3.4 percent because the fiscal growth factor is lagged. We are coming off a period of low general inflation and into a period of rapid acceleration in medical services inflation.

**How do projected revenues compare with the spending limit for 2003-05?**

The preliminary estimate of the spending limit for the 2003-05 Biennium is \$24.466 billion, based on the current spending limit for the 2001-03 Biennium. This compares with a revenue forecast of \$22.790 billion. However, the spending limit for 2003-05 will ultimately be re-based to actual expenditures for the 2001-03 Biennium, which are expected to be well below the original spending limit for the biennium. Nonetheless, revenues for the 2003-05 Biennium are still expected to be below the expenditure limit.

## 1.3 State debt limit considerations

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**How the state debt limit may affect the way you prepare your budget proposal**

The state's capacity to borrow money for certain types of capital construction is affected by how much the state can spend on debt service for general obligation bonds. This debt limit depends both on the amount of General Fund-State revenue collected and the cost of borrowing. The existing ten-year capital plan is based on assumptions of moderate growth in state revenues and slight increases in interest rates.

For the 2003-05 Biennium, interest rates are expected to remain low, but the positive effects of low interest rates will be offset by slow revenue growth. General Fund revenues are expected to grow at a rate of about 5.4 percent annually in 2003-05, a slower rate than in six of the previous eight biennia. This scenario reduces the amount of borrowing that can be done. As a result, there may be less General Fund bond capacity for capital construction in the 2003-05 Biennium.